

**NORTH DAKOTA
DEVELOPMENT FUND, INC.
(COMPONENT UNIT OF THE STATE OF
NORTH DAKOTA)**

***FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007***

NORTH DAKOTA DEVELOPMENT FUND, INC.

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INDEPENDENT AUDITOR'S REPORT

Governor of North Dakota
The Legislative Assembly

Board of Directors
North Dakota Development Fund, Inc.
Bismarck, North Dakota

We have audited the accompanying basic financial statements of the **North Dakota Development Fund, Inc.**, a component unit of the State of North Dakota, as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the **North Dakota Development Fund, Inc.** as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2008, on our consideration of the **North Dakota Development Fund, Inc.**'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying financial information on pages 21 through 24 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has been subjected to auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material respects in relation to the basic financial statements taken as a whole.

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The Management's Discussion and Analysis on pages 3 to 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Eide Bailly LLP

Bismarck, North Dakota
September 18, 2008

NORTH DAKOTA DEVELOPMENT FUND, INC.
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2008

The discussion and analysis of the financial performance of the North Dakota Development fund that follows is meant to provide additional insight into the Development Fund's activities for the year ended June 30, 2008. Please read it in conjunction with the Development Fund's financial statements and footnotes, which are presented within this report.

FINANCIAL HIGHLIGHTS:

Total revenue increased by \$369,364 (32.0%) to \$1,514,031. Operating revenues increased by \$240,071 (31.0%) to \$1,011,854. Cash flow decreased by (\$1,492,373) (19.64%) to \$6,107,915. The increase in operating revenues for year ended June 30, 2008 was attributable to the payout of investments made in prior year's by the Development Fund and increased dividend payback. The Fund collected \$3,916,683 in principal payments in 2008, which was a decrease of \$2,538,938 (39.3%) from 2007.

The Fund received \$241,843 in dividend repayment in 2008 from equity investments made, up from the \$25,129 received in dividend payments in 2007.

General & Administrative expense decreased by \$20,583 (6.0%) from \$342,036 in 2007 to \$321,453 in 2008.

Operating loss before non-operating revenues & expenses declined by (\$154,955) from (\$149,784) to (\$304,739). The decline in the operating loss in 2008 was attributable to increased reserve for bad debt expense.

Interest income on deposits increased by \$129,293 (35.0%) to \$502,177 and was the result of increased investments being made in certificates of deposit at the Bank of North Dakota and receiving higher interest rates through longer-term investments.

The change in net assets improved by \$2,974,338 from \$223,100 in 2007 to \$3,197,438 in 2008. The improvement was attributable to the NDDF receiving an appropriation for the first time since 2001 from the legislature during the last legislative session in the amount of \$3,000,000.

Net assets increased by \$3,197,438 to \$23,982,984. The increase in net assets was attributable to the appropriation received from the last North Dakota legislative session. The Fund saw increased revenue generated in 2008, which also helped in the increase of net assets.

Noncurrent net assets (excluding equipment) decreased by (\$646,052) to \$6,634,444. The noncurrent assets consist of the Fund's loan and equity investments. The equity investments made decreased by (\$63,743) from 2007 to 2008. The equity investments that were charged off during 2008 were \$75,000 as compared to \$520,000 in 2007. The loan investments made decreased by (\$582,309) from 2007 to 2008. The loan investments that were charged off during 2008 were \$629,443 as compared to \$142,444 in 2007.

21 projects were funded totaling \$5,370,926.

REQUIRED FINANCIAL STATEMENTS:

The discussion and analysis are intended to serve as an introduction to the Development Fund's financial statements. The financial statements of the Development Fund provide accounting information similar to that of many other business entities. The Balance Sheet summarizes the assets and liabilities, with the difference between the two reported as net assets. It also serves as a basis for analysis of the soundness and liquidity of the Development Fund. The statement of Revenues, Expenses and Changes in Net Assets summarize the Development Fund's operating performance for the year. The statements of Cash Flows summarize the flow of cash through the Development Fund as it conducts its business.

**CONDENSED BALANCE SHEET
JUNE 30, 2008 AND 2007**

ASSETS	2008	2007
Current assets	<u>\$ 17,361,427</u>	<u>\$ 13,517,626</u>
Capital assets	766	3,491
Other noncurrent assets	<u>6,634,444</u>	<u>7,280,496</u>
Total noncurrent assets	<u>6,635,210</u>	<u>7,283,987</u>
Total assets	<u><u>\$ 23,996,637</u></u>	<u><u>\$ 20,801,613</u></u>
NET ASSETS		
Current liabilities	\$ 13,653	\$ 16,067
Invested in capital assets, net of related debt	766	3,491
Unrestricted	<u>23,982,218</u>	<u>20,782,055</u>
Total net assets	<u>23,982,984</u>	<u>20,785,546</u>
Total liabilities and net assets	<u><u>\$ 23,996,637</u></u>	<u><u>\$ 20,801,613</u></u>

Interest receivable on deposits & loans decreased by (\$3,459) (3.0%) to \$113,543. Even though no major collections occurred on the non-accrual accounts in 2008, no additional equity investments were put on non-accrual status, which contributed to an improvement in the receivable.

Cash & cash equivalents increased by \$3,495,866 to \$3,957,363 (cash balance is before loan and investment commitments). The increase in cash was attributable to the \$3,000,000 appropriation received from the legislature during the last legislative session and increased investments made in certificates of deposit at the Bank of North Dakota to allow the Fund a greater investment return in 2008.

Cash and cash equivalents

Cash and cash equivalents consist of cash deposits with the Bank of North Dakota and are included in the current assets section of the balance sheet. Additional discussion of cash and cash equivalents can be found in Note 2 to the financial statements.

Equity investments

Equity investments consist of capital investments in new or expanding primary sector businesses in or relocating to North Dakota and are included in noncurrent assets. Additional discussion of equity investments can be found in Notes 4 and 5 to the financial statements.

Loans receivable

Loans receivable consist of loans to new or expanding primary sector businesses in or relocating to North Dakota and are included in current and noncurrent assets in the balance sheet. Additional analysis of loans receivable can be found in Notes 6 and 7.

**CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2008 AND 2007**

	2008	2007
OPERATING REVENUES		
Interest income on loans	\$ 730,484	\$ 689,486
Dividend income	241,843	25,129
Other	39,527	57,168
	<u>1,011,854</u>	<u>771,783</u>
NONOPERATING REVENUE (EXPENSE)		
State appropriations	3,000,000	-
Interest income on deposits	502,177	372,884
	<u>3,502,177</u>	<u>372,884</u>
TOTAL REVENUE	<u>4,514,031</u>	<u>1,144,667</u>
OPERATING EXPENSES		
General and administrative	321,453	342,036
Depreciation expense	3,491	5,985
Bad debt expense	991,649	573,546
	<u>1,316,593</u>	<u>921,567</u>
CHANGE IN NET ASSETS	3,197,438	223,100
NET ASSETS, BEGINNING OF YEAR	<u>20,785,546</u>	20,562,446
NET ASSETS, END OF YEAR	<u><u>\$ 23,982,984</u></u>	<u><u>\$ 20,785,546</u></u>

Contacting the North Dakota Development Fund's financial management:

The information in this report is intended to provide the reader with an overview of the Development Fund's accountability for those operations. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the North Dakota Development Fund, PO Box 2057, Bismarck, ND 58502-2057.

NORTH DAKOTA DEVELOPMENT FUND, INC.
BALANCE SHEETS
JUNE 30, 2008 AND 2007

ASSETS	2008	2007
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,957,363	\$ 461,497
Interest receivable on deposits and loans	113,543	117,002
Investments	9,879,726	9,931,426
Current portion of loans receivable	3,410,795	3,007,701
Total current assets	17,361,427	13,517,626
NONCURRENT ASSETS		
Equity investments, net	1,367,222	1,430,965
Loans receivable, net of current portion	5,267,222	5,849,531
Equipment, net	766	3,491
Total noncurrent assets	6,635,210	7,283,987
Total assets	\$ 23,996,637	\$ 20,801,613
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Accrued expenses	\$ 13,653	\$ 16,067
NET ASSETS		
Invested in capital assets	766	3,491
Unrestricted	23,982,218	20,782,055
Total net assets	23,982,984	20,785,546
Total liabilities and net assets	\$ 23,996,637	\$ 20,801,613

NORTH DAKOTA DEVELOPMENT FUND, INC.
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
OPERATING REVENUES		
Interest income on loans	\$ 730,484	\$ 689,486
Dividend income	241,843	25,129
Other	39,527	57,168
	<u>1,011,854</u>	<u>771,783</u>
OPERATING EXPENSES		
General and administrative	321,453	342,036
Depreciation expense	3,491	5,985
Bad debt expense	991,649	573,546
	<u>1,316,593</u>	<u>921,567</u>
OPERATING LOSS	(304,739)	(149,784)
NONOPERATING REVENUE		
State appropriations	3,000,000	-
Interest income on deposits and investments	502,177	372,884
	<u>3,502,177</u>	<u>372,884</u>
CHANGE IN NET ASSETS	3,197,438	223,100
NET ASSETS, BEGINNING OF YEAR	<u>20,785,546</u>	<u>20,562,446</u>
NET ASSETS, END OF YEAR	<u>\$ 23,982,984</u>	<u>\$ 20,785,546</u>

NORTH DAKOTA DEVELOPMENT FUND, INC.
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
OPERATING ACTIVITIES		
Other receipts	\$ 253,728	\$ (216,145)
Payments to suppliers	<u>(323,867)</u>	<u>(345,602)</u>
Net cash (used for) provided by operating activities	<u>(70,139)</u>	<u>(561,747)</u>
INVESTING ACTIVITIES		
Interest received on cash and cash equivalents	1,292,112	1,097,846
Purchase of equipment	(766)	-
Purchase of equity investments	(1,033,457)	(1,100,000)
Proceeds from the sale of equity investments	677,201	148,987
Purchase of investments	(28,967,526)	(31,962,425)
Sale of investments	29,019,226	29,378,969
Disbursements of business loans	(4,337,468)	(5,509,229)
Principal payments received on business loans	<u>3,916,683</u>	<u>6,455,621</u>
Net cash (used for) provided by investing activities	<u>566,005</u>	<u>(1,490,231)</u>
NON-CAPITAL AND RELATED		
FINANCING ACTIVITIES		
Proceeds from state appropriations	<u>3,000,000</u>	<u>-</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,495,866	(2,051,978)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>461,497</u>	<u>2,513,475</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 3,957,363</u>	<u>\$ 461,497</u>

STATEMENT OF CASH FLOWS – page 2

	<u>2008</u>	<u>2007</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating loss	\$ (304,739)	\$ (149,784)
Adjustments to reconcile operating loss to net cash from operating activities		
Depreciation	3,491	5,985
Allowance for doubtful loan receivables	600,000	50,000
Allowance for realized loss on investments	420,000	535,000
Reclassification of interest and dividend income	(786,477)	(699,382)
Changes in assets and liabilities		
Due to related party	-	(300,000)
Accrued expenses	(2,414)	(3,566)
Net cash provided by (used for) operating activities	<u>\$ (70,139)</u>	<u>\$ (561,747)</u>
SUPPLEMENTAL SCHEDULE OF NONCASH ACTIVITIES		
Equity investments written off	\$ 75,000	\$ 520,000
Loans receivable written off	629,443	142,444

NORTH DAKOTA DEVELOPMENT FUND, INC.
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2008 AND 2007

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Nature of Activities

The North Dakota Development Fund, Inc. (the Corporation) was established pursuant to Chapter 10-30.3 of the North Dakota Century Code as amended by the passage of Senate Bill 2058 during the 1991 legislative session. The Corporation is a statewide nonprofit development corporation with the authority to take equity positions in; to provide loans to; or to use other innovative financing mechanisms to provide capital for new or expanding primary sector businesses in North Dakota or relocating to North Dakota.

The Corporation uses funds to report on its financial position and the results of its operations. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain corporate functions or activities.

The following activities are used by the Corporation:

Development Fund

The Development Fund is used to account for fund investments, including equity positions, loans, loan guarantees, and other innovative financing mechanisms for new or expanding primary sector businesses in North Dakota or relocating to North Dakota.

Regional Rural Development Revolving Loan Fund

The Regional Rural Development Revolving Loan Fund is used to account for fund investments including equity positions, loans, loan guarantees, or debt financing on a matching basis to new or expanding primary sector businesses in rural areas.

The Corporation may form additional corporations, partnerships or other forms of business associations in order to further its mission.

Reporting Entity

The Director of the Department of Commerce Division of the Economic Development and Finance shall appoint the Chief Executive Officer of the Corporation. All investments, contracts, partnerships, limited liability companies, and business transactions of the Corporation are the responsibility of the Chief Executive Officer and the eight-member Board of Directors, who are appointed by the Governor.

NOTES TO FINANCIAL STATEMENTS

Reporting Entity

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, the Corporation should include all component units over which the Corporation exercises such aspects as (1) appointing a voting majority of an organization's governing body and (2) has the ability to impose its will on that organization or (3) the potential for the organization to provide specific financial benefits to, or impose specific burdens on the Corporation. GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*, an Amendment of GASB Statement 14, further defined reporting units as a legally separate, tax exempt affiliated organization that meet all of the following criteria:

- The economic resources of the organization entirely or almost entirely directly benefit the Corporation or its constituents, and
- The Corporation or its component units are entitled to or can otherwise access, a majority of the economic resources of the organization, and
- The economic resources that the Corporation is entitled to, or can otherwise access, are significant to the Corporation.

Based upon criteria set forth in GASB No. 14 and No. 39, no organizations were determined to be part of the reporting entity. The Corporation is included as part of the primary government of the State of North Dakota's reporting entity.

Basis of Accounting

The Corporation is presented in the accompanying financial statements as a proprietary fund type – an enterprise fund.

An enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent is that costs of providing goods or services to the general public or other funds on a continuing basis be financed or recovered primarily through user charges. The Corporation operates primarily with appropriations from the general fund.

As a proprietary fund type, the Corporation accounts for its transactions using the accrual basis of accounting. Revenues are recognized for its transactions when they are earned, and expenses are recognized when they are incurred.

The Corporation follows the pronouncements of the Governmental Accounting Standards Board (GASB), which is the nationally accepted standard-setting body for establishing generally accepted accounting principles for governmental entities. In accordance with Governmental Accounting Standards Board Statement 20, the Corporation follows all applicable GASB Pronouncements as well as Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with GASB pronouncements.

NOTES TO FINANCIAL STATEMENTS

Revenue and Expense Recognition

The Corporation presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the Corporation. Operating revenues include all charges to customers, research contracts and grants, dividends earned on equity investments and interest earned on loans. Revenues from nonexchange transactions and state appropriations that represent subsidies or gifts to the Corporation, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital or noncapital financing activities. Revenues received for capital financing activities, as well as related expenses, are considered neither operating nor nonoperating activities and are presented after nonoperating activities on the accompanying Statement of Revenues, Expenses, and Changes in Net Assets.

Concentration of Credit Risk

Loans receivable consist primarily of loans to new or expanding businesses in North Dakota or relocating businesses to North Dakota. The Corporation performs credit evaluations and maintains a security interest until related loans are collected.

Cash Equivalents

The Corporation considers all highly liquid investments purchased with maturity of three months or less to be cash equivalents.

Investments

Investments are reported at fair value. All investment income, including changes in the fair value of investments, is recognized in the statement of revenue, expenses, and changes in fund net assets.

Equity Investments

The Corporation records its equity investments at cost adjusted for other than temporary impairment as determined by the Board of Directors. The other than temporary impairment of equity investments is included in fund equity. Realization of the carrying value of these investments is subject to future developments inherent in such investments (see Note 4).

Among the factors considered in determining whether an other than temporary impairment of an investment has occurred are the cost of the investment, development since the acquisition of the investment, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, and other factors generally pertinent to the valuation of investments. The Development Fund has relied on financial data of investees and, in many instances, on estimates by the management company and of the investee company as to the potential effect of future developments.

Expense Allocation

The Development Fund pays all expenses of the Corporation.

NOTES TO FINANCIAL STATEMENTS

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the allowance for loan losses and valuation of equity investments.

Fixed Assets and Depreciation

All fixed assets are recorded in the accompanying financial statements at cost. Donated fixed assets are stated at fair market value at the time of donation. Equipment with a cost greater than \$5,000 is capitalized and reported in the accompanying financial statements. The Corporation's fixed assets are being depreciated on a straight-line basis over estimated useful life of 3 years.

Loans

Loans are reported at their outstanding unpaid principal adjusted for charge-offs and the allowance for loan losses.

Interest income is accrued on the unpaid principal balance. The accrual of interest on loans is discontinued at the time the loan is 90 to 120 days delinquent unless the credit is well secured and in process of collection. Loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is doubtful. All current year interest accrued but not collected for loans that are placed on non-accrual or charged off is reversed against interest income. All prior year interest accrued but not collected is charged-off against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

The Corporation has determined that the accounting for nonrefundable fees and costs associated with originating or acquiring loans does not have a material effect on their financial statements. As such, these fees and costs have been recognized during the period they are collected and incurred, respectively.

Allowance For Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to a recovery account.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

NOTES TO FINANCIAL STATEMENTS

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. The Corporation separately identifies individual loans for impairment disclosures by rating them on a scale of 1 to 6.

NOTE 2 - DEPOSITS AND INVESTMENTS

The Corporation is required to maintain its deposits at the Bank of North Dakota. As of June 30, 2008, the Corporation had the following cash and investments:

	Fair Value	Less Than One Year
Cash		
Bank of North Dakota	\$ 3,957,363	\$ 3,957,363
Investments		
Certificates of deposit		
Bank of North Dakota	9,879,726	9,879,726
	<u>\$ 13,837,089</u>	<u>\$ 13,837,089</u>

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of investments will adversely affect the fair value of the investments. At June 30, 2008, the schedule above shows the investments by investment type, amount and the duration.

Cash and investments were recorded on the statement of net assets as follows:

	Balance
Cash and cash equivalents	\$ 3,957,363
Investments	9,879,726
	<u>\$ 13,837,089</u>

NOTES TO FINANCIAL STATEMENTS

Custodial and Concentration of Credit Risk

For deposits and investments, the custodial credit risk that, in the event of the failure of a depository financial institution, the Corporation will not be able to recover collateral securities that are in possession of an outside party. The Corporation's deposits are uncollateralized. All of the Corporation's deposits and investments are with the Bank of North Dakota.

NOTE 3 – INTEREST RECEIVABLE

Interest receivable at June 30, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Due from Bank of North Dakota	\$ 8,006	\$ 8,389
Interest receivable from loans	<u>105,537</u>	<u>108,613</u>
	<u>\$ 113,543</u>	<u>\$ 117,002</u>

NOTE 4 - EQUITY INVESTMENTS

Equity investments in business concerns as of June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Development Fund	\$ 3,879,634	\$ 3,829,879
Regional Rural Development Revolving Loan Fund	<u>1,579,945</u>	<u>1,348,443</u>
	<u>5,459,579</u>	<u>5,178,322</u>
Valuation allowance - Other than temporary impairment	<u>(4,092,357)</u>	<u>(3,747,357)</u>
	<u>\$ 1,367,222</u>	<u>\$ 1,430,965</u>

Among the factors considered in determining whether an other than temporary impairment of an investment has occurred are the cost of the investment, development since the acquisition of the investment, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, and other factors generally pertinent to the valuation of investments. The Development Fund has relied on financial data of investees and, in many instances, on estimates by the management company and of the investee company as to the potential effect of future developments.

The Corporation acquired its investment by direct purchase from the issuer under investment representations, and the Board of Directors valued the securities on the premise that they may not be sold without registration under the Securities Act of 1933. The price of securities purchased was determined by direct negotiation between the Corporation and the seller.

NOTES TO FINANCIAL STATEMENTS

NOTE 5 – EQUITY INVESTMENTS – VALUATION ALLOWANCE

Changes in the valuation allowance for equity investments as of June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 3,747,357	\$ 3,732,357
Provision for equity investment losses	420,000	535,000
Equity investments charged off	<u>(75,000)</u>	<u>(520,000)</u>
Balance, end of year	<u>\$ 4,092,357</u>	<u>\$ 3,747,357</u>

NOTE 6 - LOANS RECEIVABLE

Loans receivable at June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Development Fund	\$ 8,248,551	\$ 9,134,839
Regional Rural Development Revolving Loan Fund	<u>6,578,468</u>	<u>5,929,190</u>
	14,827,019	15,064,029
Allowance for loan losses	<u>(6,149,002)</u>	<u>(6,206,797)</u>
Loans receivable, net of allowance for loan losses	8,678,017	8,857,232
Less: current portion of loans receivable	<u>3,410,795</u>	<u>3,007,701</u>
Loans receivable, net of current portion	<u>\$ 5,267,222</u>	<u>\$ 5,849,531</u>

Notes receivable of \$1,120,039 and \$1,148,390 at June 30, 2008 and 2007, respectively, do not have set repayment dates and are not interest bearing. The receivables will be repaid through royalties based on a set percentage of gross sales. The agreements provide for repayment between 100% to 167% of the outstanding note balance upon the funded product reaching commercialization. If the product does not reach commercialization, generally, the note does not have to be repaid.

NOTES TO FINANCIAL STATEMENTS

NOTE 7 – ALLOWANCE FOR LOAN LOSSES

Changes in the allowance for loan losses as of June 30, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Balance, beginning of year	\$ 6,206,797	\$ 6,310,695
Provision for loan losses	600,000	50,000
Recovery of loans charged off	(28,351)	(11,454)
Loans charged off	<u>(629,444)</u>	<u>(142,444)</u>
Balance, end of year	<u><u>\$ 6,149,002</u></u>	<u><u>\$ 6,206,797</u></u>

NOTE 8 - EQUIPMENT

A statement of changes in fixed assets for the years ended June 30, 2008 and 2007 is as follows:

	<u>Balance 06/30/07</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 06/30/08</u>
Furniture and equipment	\$ 10,095	\$ -	\$ -	\$ 10,095
Computer software	76,579	766	-	77,345
Accumulated depreciation	<u>(83,183)</u>	<u>(3,491)</u>	<u>-</u>	<u>(86,674)</u>
	<u><u>\$ 3,491</u></u>	<u><u>\$ (2,725)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 766</u></u>

	<u>Balance 06/30/06</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 06/30/07</u>
Furniture and equipment	\$ 10,095	\$ -	\$ -	\$ 10,095
Computer software	76,579	-	-	76,579
Accumulated depreciation	<u>(77,198)</u>	<u>(5,985)</u>	<u>-</u>	<u>(83,183)</u>
	<u><u>\$ 9,476</u></u>	<u><u>\$ (5,985)</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 3,491</u></u>

NOTES TO FINANCIAL STATEMENTS

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Management has designated net assets to cover any commitments or guarantees approved by the Board of Directors.

Development Fund

The Board of Directors has approved equity investments, loans, grants and guaranty of collections at June 30, 2008 and 2007, for which funds have not been disbursed or written agreements entered into in the approximate amount of \$2,624,000 and \$2,830,000.

On June 28, 1992, the Corporation signed a guaranty of collection on a REC loan that Frost Fire Mountain has with Cavalier Rural Electric Cooperative. The amount guaranteed is 35 percent of the unsatisfied balance or \$9,760 whichever is less.

Regional Rural Development Revolving Loan Fund

The Board of Directors has approved equity investments, loans, and guaranty of collections at June 30, 2008 and 2007, for which funds have not been disbursed or written agreements entered into in the approximate amount of \$3,073,000 and \$1,764,000.

NOTE 10 - RISK MANAGEMENT

North Dakota Development Fund, Inc. is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The following are funds/pools established by the State for risk management issues:

The 1995 Legislative Session established the Risk Management Fund (RMF), an internal service fund, to provide a self-insurance vehicle for funding the liability exposures of state agencies resulting from the elimination of the state's sovereign immunity. The RMF manages the tort liability of the state, its agencies' employees, and the University System. All state agencies participate in the RMF and their fund contribution was determined using a projected cost allocation approach. The statutory liability of the State is limited to a total of \$250,000 per person and \$1,000,000 per occurrence.

The Corporation participates in the North Dakota Fire and Tornado Fund and the State Bonding Fund through the policies of the North Dakota Commerce Department. North Dakota Commerce Department pays an annual premium to the Fire and Tornado Fund to cover property damage to personal property. Replacement cost coverage is provided by estimating replacement cost in consultation with the Fire and Tornado Fund. The Fire and Tornado Fund is reinsured by a third party insurance carrier for losses in excess of one million dollars per occurrence during a twelve-month period. The State Bonding Fund currently provides the Agency with blanket fidelity bond coverage in the amount of \$100,000 per employee. The State Bonding Fund does not currently charge any premium for this coverage.

NOTES TO FINANCIAL STATEMENTS

The Corporation participates in the North Dakota Workforce Safety and Insurance, (WSI) an Enterprise Fund of the State of North Dakota. WSI is a state insurance fund and a "no fault" insurance system covering the State's employers and employees financed by premiums assessed to employers. The premiums are available for the payment of claims to employees injured in the course of employment.

There have been no significant reductions in insurance coverage from the prior year and settled claims resulting from these risks have not exceeded insurance coverage in any of the past three fiscal years.

NOTE 11 – SUBSEQUENT EVENT

In July 2008, the Development Fund signed a service agreement with the Bank of North Dakota to assume the administrative duties of managing the New Venture Capital Program on behalf of the Bank of North Dakota. The Development Fund officially took over full administrative duties of managing the Fund on July 31, 2008.

NORTH DAKOTA DEVELOPMENT FUND, INC.
COMBINING BALANCE SHEETS
JUNE 30, 2008 AND 2007

	Development Fund	Regional Rural Development Revolving Loan Fund	Elimin- ations	2008	2007
ASSETS					
CURRENT ASSETS					
Cash and cash equivalents	\$ 2,984,809	\$ 972,554	\$	\$ 3,957,363	\$ 461,497
Interest receivable on deposits and loans	71,269	42,274		113,543	117,002
Investments	7,879,726	2,000,000		9,879,726	9,931,426
Current portion of loans receivable	2,351,122	1,059,673		3,410,795	3,007,701
Intercompany receivable (payable)	45,493	(45,493)		-	-
Total current assets	<u>13,332,419</u>	<u>4,029,008</u>	<u>-</u>	<u>17,361,427</u>	<u>13,517,626</u>
NONCURRENT ASSETS					
Equity investments, net	627,259	739,963		1,367,222	1,430,965
Loans receivable, net of current portion	2,138,804	3,128,418		5,267,222	5,849,531
Equipment, net	766	-		766	3,491
Total noncurrent assets	<u>2,766,829</u>	<u>3,868,381</u>	<u>-</u>	<u>6,635,210</u>	<u>7,283,987</u>
Total assets	<u>\$ 16,099,248</u>	<u>\$ 7,897,389</u>	<u>\$ -</u>	<u>\$ 23,996,637</u>	<u>\$ 20,801,613</u>
LIABILITIES AND NET ASSETS					
CURRENT LIABILITIES					
Due to related party	\$ -	\$ -	\$	\$ -	\$ -
Accrued expenses	13,653	-		13,653	16,067
Total current liabilities	<u>13,653</u>	<u>-</u>	<u>-</u>	<u>13,653</u>	<u>16,067</u>
NET ASSETS					
Invested in capital assets, net of related debt	766	-		766	3,491
Unrestricted	16,084,829	7,897,389		23,982,218	20,782,055
Total net assets	<u>16,085,595</u>	<u>7,897,389</u>	<u>-</u>	<u>23,982,984</u>	<u>20,785,546</u>
Total liabilities and net assets	<u>\$ 16,099,248</u>	<u>\$ 7,897,389</u>	<u>\$ -</u>	<u>\$ 23,996,637</u>	<u>\$ 20,801,613</u>

NORTH DAKOTA DEVELOPMENT FUND, INC.
COMBINING STATEMENTS OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2008 AND 2007

	Development Fund	Regional Rural Development Revolving Loan Fund	Elimin- ations	2008	2007
OPERATING REVENUES					
Interest income on loans	\$ 380,497	\$ 349,987	\$	\$ 730,484	\$ 689,486
Dividend income	185,850	55,993		241,843	25,129
Other	27,684	11,843		39,527	57,168
	<u>594,031</u>	<u>417,823</u>		<u>1,011,854</u>	<u>771,783</u>
OPERATING EXPENSES					
General and administrative	321,453	-		321,453	342,036
Depreciation expense	3,491	-		3,491	5,985
Bad debt expense	596,649	395,000		991,649	573,546
	<u>921,593</u>	<u>395,000</u>		<u>1,316,593</u>	<u>921,567</u>
OPERATING (LOSS) INCOME	(327,562)	22,823		(304,739)	(149,784)
NONOPERATING REVENUE (EXPENSE)					
Interest income on deposits and investments	390,166	112,011		502,177	372,884
State appropriations	3,000,000	-		3,000,000	-
	<u>3,390,166</u>	<u>112,011</u>	<u>-</u>	<u>3,502,177</u>	<u>372,884</u>
CHANGE IN NET ASSETS	3,062,604	134,834		3,197,438	223,100
NET ASSETS, BEGINNING OF YEAR	<u>13,022,991</u>	<u>7,762,555</u>		<u>20,785,546</u>	<u>20,562,446</u>
NET ASSETS, END OF YEAR	<u>\$ 16,085,595</u>	<u>\$ 7,897,389</u>	<u>\$</u>	<u>\$ 23,982,984</u>	<u>\$ 20,785,546</u>

NORTH DAKOTA DEVELOPMENT FUND, INC.
COMBINING STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	Development Fund	Regional Rural Development Revolving Loan Fund	Elimina- tions	2008	2007
OPERATING ACTIVITIES					
Other receipts (payments)	\$ 241,885	\$ 11,843	\$ -	\$ 253,728	\$ (216,145)
Payments to suppliers	(323,867)	-		(323,867)	(345,602)
NET CASH (USED FOR) PROVIDED BY OPERATING ACTIVITIES	(81,982)	11,843	-	(70,139)	(561,747)
NON-CAPITAL FINANCING ACTIVITIES					
Proceeds from state appropriations	3,000,000	-	-	3,000,000	-
Due from Rural Fund	(857)	-	857	-	-
Due to Development Fund	-	857	(857)	-	-
NET CASH (USED FOR) PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	2,999,143	857	-	3,000,000	-
INVESTING ACTIVITIES					
Interest and dividends received	764,035	528,077		1,292,112	1,097,846
Purchase of equipment	(766)	-		(766)	-
Purchase of equity investments	(625,124)	(408,333)		(1,033,457)	(1,100,000)
Proceeds from the sale of equity investments	500,370	176,831		677,201	148,987
Purchase of investments	(20,395,226)	(8,572,300)		(28,967,526)	(31,962,425)
Sale of investments	19,246,826	9,772,400		29,019,226	29,378,969
Disbursements of business loans	(2,120,000)	(2,217,468)		(4,337,468)	(5,509,229)
Principal received on business loans	2,533,212	1,383,471		3,916,683	6,455,621
NET CASH (USED FOR) PROVIDED BY INVESTING ACTIVITIES	(96,673)	662,678		566,005	(1,490,231)
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,820,488	675,378	-	3,495,866	(2,051,978)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	164,321	297,176		461,497	2,513,475
CASH AND CASH EQUIVALENTS AT END OF YEAR	\$ 2,984,809	\$ 972,554	\$	\$ 3,957,363	\$ 461,497

(continued on next page)

COMBINING STATEMENT OF CASH FLOWS – page 2

	Development Fund	Regional Rural Development Revolving Loan Fund	Elimina- tions	2008	2007
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES					
Operating loss	\$ (327,562)	\$ 22,823	\$	\$ (304,739)	\$ (149,784)
Adjustments to reconcile operating loss to net cash from operating activities:					
Depreciation	3,491	-		3,491	5,985
Allowance for doubtful loan receivables	300,000	300,000		600,000	50,000
Allowance for realized loss on investments	325,000	95,000		420,000	535,000
Reclassification of interest and dividend income	(380,497)	(405,980)		(786,477)	(699,382)
Changes in assets and liabilities					
Due to related party		-		-	(300,000)
Accrued expenses	(2,414)	-		(2,414)	(3,566)
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	<u>\$ (81,982)</u>	<u>\$ 11,843</u>	<u>\$</u>	<u>\$ (70,139)</u>	<u>\$ (561,747)</u>
SUPPLEMENTAL SCHEDULE OF NONCASH ACTIVITIES					
Equity investments written off	\$ 75,000	\$ -	\$	\$ 75,000	\$ 520,000
Loan receivable written off	444,725	184,718		629,443	142,444



INDEPENDENT AUDITOR'S SPECIFIC COMMENTS REQUESTED BY THE NORTH DAKOTA LEGISLATIVE AUDIT AND FISCAL REVIEW COMMITTEE

Governor of North Dakota
The Legislative Assembly

Board of Directors
North Dakota Development Fund, Inc.
Bismarck, North Dakota

The Legislative Audit and Fiscal Review Committee requires that certain items be addressed by independent certified public accountants performing audits of state agencies. The items and our responses regarding the June 30, 2008 audit of the **North Dakota Development Fund, Inc.** (the Corporation) are as follows:

1. What type of opinion was issued on the financial statements?

Unqualified.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and functioning?

Yes.

3. Was internal control adequate and functioning effectively?

Yes.

4. Were there indications of lack of efficiency in financial operations and management of the agency?

No.

5. Has action been taken on findings and recommendations included in prior audit reports?

No prior year findings or recommendations.

- 6. Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.**

A management letter was issued without any recommendations or findings.

- 7. Identify any significant changes in accounting policies, any management conflicts of interest, and contingent liabilities, or any significant unusual transactions?**

None.

- 8. Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates?**

The most sensitive estimates affecting the financial statements include the allowance for uncollectible loans receivable, valuation allowance for equity investments, and estimated useful lives of property and equipment.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Among the factors considered in determining whether an other than temporary impairment of an investment has occurred are the cost of the investment, development since the acquisition of the investment, the financial condition and operating results of the issuer, the long-term potential of the business of the issuer, and other factors generally pertinent to the valuation of investments. The Development Fund has relied on financial data of investees and, in many instances, on estimates by the management company and of the investee company as to the potential effect of future developments.

Our opinion on the reasonableness of these estimates is based on the testing performed during our audit procedures. Our procedures included assessing the risk assigned by the Corporation the loans and equity investments, evaluation of the past history of these amounts, discussion with management, and review of recent information regarding the loans and investments.

- 9. Identify any significant audit adjustments.**

None.

- 10. Identify any disagreements with management, whether or not resolved to the auditor's satisfaction, relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.**

None.

- 11. Identify any serious difficulties encountered in performing the audit.**

None.

12. Identify any major issues discussed with management prior to retention.

None.

13. Identify any management consultations with other accountants about auditing and accounting matters.

None.

14. Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission or whether any exceptions identified in the six audit report questions to be addressed by auditors are directly related to the operations of an information technology system.

The Corporation uses SPARAK for its accounting and operations. We noted no internal control issues or exceptions related to the information system used by the Corporation.

This report is intended solely for the information and use of the Legislative Audit and Fiscal Review Committee, **North Dakota Development Fund, Inc.** Board of Directors and other state officials and legislative committees and is not intended to be and should not be used by anyone other than these specified parties.

Erde Bailly LLP

Bismarck, North Dakota
September 18, 2008



**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Governor of North Dakota
The Legislative Assembly

Board of Directors
North Dakota Development Fund, Inc.
Bismarck, North Dakota

We have audited the financial statements of **North Dakota Development Fund, Inc.**, as of and for the year ended June 30, 2008, and have issued our report thereon dated September 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered **North Dakota Development Fund, Inc.**'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **North Dakota Development Fund, Inc.**'s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies in internal control over financial reporting that we consider to be significant deficiencies. We did not note any deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the **North Dakota Development Fund, Inc.**'s internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be presented or detected by the **North Dakota Development Fund, Inc.**'s internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, considered to be material weaknesses. We noted no deficiencies in internal control that we consider a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **North Dakota Development Fund, Inc.**'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, management, the North Dakota Legislative Council and other state officials and is not intended to be and should not be used by anyone other than these specified parties.

Erde Bailly LLP

Bismarck, North Dakota
September 18, 2008

NORTH DAKOTA DEVELOPMENT FUND
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2008

None.